Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Nakano | Analyst: LuAnna Hass | Bill Number: AB 273

Related Bills: See Prior Analysis | Telephone: 845-7478 | Amended Date: April 16, 2001

Attorney: Patrick Kusiak | Sponsor: ______

SUBJECT: First-Time Homebuyer Mortgage Insurance Deduction

____	DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended__________________________.
X	AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
X	AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced February 16, 2001.
X	FURTHER AMENDMENTS NECESSARY.
____	DEPARTMENT POSITION CHANGED TO __________________________.
X	REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED February 16, 2001, STILL APPLIES.
____	OTHER - See comments below.

SUMMARY

This bill would allow a first-time homebuyer to claim the amount paid for specified mortgage insurance or funding fees as a deduction.

SUMMARY OF AMENDMENT

The April 16, 2001, amendments specified that a deduction would be allowed for private mortgage insurance (PMI), mortgage insurance protection in connection with a Federal Housing Authority (FHA) loan, or funding fees in connection with a Veterans Administration (VA) loan. Except for the implementation considerations and a new revenue estimate, the department's analysis of the bill as introduced February 16, 2001, still applies. The following implementation considerations stil apply and are included below for convenience. The department also is including an updated revenue estimate.

POSITION

Pending.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	04/24/01
____ N	____ OUA	X PENDING		

IMPLEMENTATION CONCERNS

The term “private mortgage insurance” is undefined. It is unclear what specific types of insurance payments qualify for the deduction. The federal "Homeowners Protection Act of 1998" provides a definition for PMI. The author may wish to use that definition in this bill.

This bill uses the term “funding fees” in relation to a Veterans Administration loan. Although the department understands that the intended fee is the fee required by law, the author may wish to include a cross-reference in this bill to specifically define this term.

The definition of first-time homebuyer in the Health and Safety Code is linked to laws within the same code relating to mortgages issued by city and county housing agencies. Consequently, the buyer of a home financed with a mortgage obtained from some other source would not qualify for the deduction.

The bill uses the term “first-time home buyer” as defined in the Health and Safety Code. It is defined as a person who purchases an owner-occupied housing unit. It specifies that the person may not own or have owned a principal residence during the **three-year** period prior to the date a mortgage governed by provisions of the Health and Safety Code was executed. However, current federal and state tax laws define the same term with the requirement being the **two-year** period prior to the date of acquiring a principal residence.

In addition, the term “principal residence,” as used in the Health and Safety Code, is not clearly defined. The term “principal residence” for federal and state tax purposes means property owned and used by a taxpayer as the taxpayer’s principal residence. It may be confusing for taxpayers to have different definitions of the same terms being used for tax purposes.

This bill specifies that the deduction would cease for the taxable year when 20% of the amount of the mortgage becomes paid. However, it is the author’s intent that the deduction would cease when equity has reached 20% of the original value of the property. The author may want to amend this bill so that it is clear that the term “amount” does not refer to loan interest or principal.

However, calculating the equity percentage may be confusing to taxpayers. Since federal law requires that PMI terminate when equity in the home reaches 22%, the author may wish to remove the reference to the 20% figure so that the deduction is available as long as PMI is paid (which will cease by law at approximately the same time as the 20% figure provided in the bill).

This deduction may be complex for taxpayers to calculate since it would be included as part of the taxpayer’s miscellaneous itemized deductions and deductible only to the extent that it exceeds 2% of AGI.

ECONOMIC IMPACT

TAX REVENUE ESTIMATE

Based on limited data and assumptions discussed below, this bill would result in the following revenue losses under the Personal Income Tax Law.

Estimated Revenue Impact of AB 273 As Amended 4/16/01 [$ In Millions]		
2001-02	2002-03	2003-04
-$5	-$5	-$5

The bill would be effective with taxable years beginning on or after January 1, 2001, with enactment assumed after June 30.

TAX REVENUE DISCUSSION

The April 16, 2001, amendments increased the revenue estimate by $4 million annually. As amended, the bill expanded the types of eligible mortgage insurance to include that required for FHA and VA-guaranteed home loans.

The amount of deductible mortgage insurance premiums (premiums that exceed the 2% of adjusted gross income threshold) and marginal tax rates of taxpayers with deductible premiums would determine the revenue impact of this bill.

Estimates are based on projected premiums paid by first-time homebuyers in California relative to new and existing loans (as applicable) for conventional, FHA, and VA loans. For 2001, projected premiums total on the order of $800 million. As a miscellaneous itemized deduction, mortgage insurance premiums would be included with other miscellaneous itemized deductions, if any, and would be deductible only to the extent they exceed 2% of adjusted gross income. By using personal income tax sample data and a series of assumptions as a proxy, deductible premiums are estimated to be on the order of $80 million. Applying an average marginal tax rate of 6% derives the estimates above.

PMI estimates are based on the approximate number of policies insuring conventional loans for first-time homebuyers nationwide: 2.6 million. It is assumed that California's distributive share of PMI policies is roughly equal to the number of owner occupied homes in California versus the nation, approximately 10%, or 265,000 policies. PMI premiums can be paid on either a monthly, annual, or single premium plan. According to industry contacts, 95% of policy premiums are paid monthly. Premiums are based on the amount and terms of the mortgage and will vary according to loan-to-value ratio, type of loan, and amount of coverage required by a lender. An average monthly premium of $75 was used for the estimate. For new loans, six months of monthly premiums were included to reflect a mid-year home purchase date. The average PMI policy is in force for less than five years. For first-time homebuyers, PMI premiums are estimated at $215 million.

Mortgage insurance protection premiums (MIP) estimates are based on the number of new FHA loans to first-time homebuyers in California in 2001: projected to exceed 200,000. The average loan is $115,000. FHA requires an up-front premium of a specified rate of the loan and is paid at closing or financed into the mortgage amount. Estimates assume that the up-front premium is considered paid at closing. Approximately two-thirds of borrowers pay an up-front premium equal to 2.5% of the mortgage amount, and one-third pay 1.75%. The monthly premium would equal 0.5% of the mortgage amount. For new loans, six months of monthly premiums were included to reflect a mid-year home purchase date. The monthly premium also was used as a proxy to estimate the annual premiums paid by qualifying first-time homeowners with existing FHA loans. Estimated premiums for new and existing loans totaled on the order of $525 million.

Funding fee estimates are based on fees paid by veterans who are first-time homebuyers in California. For VA-guaranteed home loans, a funding fee is the equivalent of a mortgage insurance premium. The funding fee is based on the amount of the mortgage and will vary according to loan-to-value ratio. The fee may be paid in cash or included in the loan amount. Estimates assume that the funding fee is considered paid at closing. According to the Department of Veterans Affairs, funding fees attributed to first-time homebuyers in California are on the order of $40 million.

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